Report

of the

Examination of

Theresa Mutual Insurance Company

Theresa, Wisconsin

As of December 31, 2003

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State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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June 21, 2004

Honorable Jorge Gomez
Commissioner of Insurance
State of Wisconsin
125 South Webster Street
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of December 31, 2003, of the affairs and financial condition of:

THERESA MUTUAL INSURANCE COMPANY
Theresa, Wisconsin

and the following report thereon is respectfully submitted:

I. INTRODUCTION

The previous examination of Theresa Mutual Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2003, and included a review of such subsequent transactions deemed essential to complete this examination.

The “Summary of Examination Results” contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company on January 7, 1879, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Theresa Mutual Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were three amendments to the articles of incorporation and no amendments to the bylaws. The articles were amended on March 3, 2001, to expand the company's insuring territory to include Columbia and Green Lake counties. On May 24, 2002, the notice section was amended to reflect the change in location of annual meetings from the Village of Theresa to Theresa, Wisconsin. On March 6, 2004, the insuring territory was expanded to include Marquette county.

The company is currently licensed to write property, including windstorm and hail, and non-property insurance. The company is currently licensed to write business in the following counties:

Columbia	Green Lake
Dodge	Marquette
Fond du Lac	Washington

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of three years with premiums payable on the advance premium basis. Commercial policies with liability coverage are written for a one-year term. Policy fees are not charged. However, the company does charge a $3.00 service fee per payment for those policyholders who wish to make quarterly or semiannual premium payments of less than $200.00.

Business of the company is acquired through thirteen agents, five of whom are directors of the company. Agents are presently compensated for their services as follows:

Type of Policy	**Compensation**
All policies	14%

Agents may also receive an additional annual bonus commission, which is determined by the board of directors at the end of the year based on company performance, on new property business written for fire and extended coverage. The current bonus commission rate is 15%.

All losses are adjusted by members of the company's board of directors, unless a private adjuster is used. Board members who are also agents do not have authority to adjust losses covering their own policyholders under the company's formal loss adjusting guidelines.

The number of adjusters for a claim typically varies from one to three depending on claim size and overall assessments of the claim type and the cause of loss made by the company officers. Larger losses are adjusted by members of the Large Loss Adjusting Committee, which is comprised of the company officers, or a private adjuster. The use of private adjusters is determined by the president or the secretary based on the complexity of the claim or as other special circumstances warrant. Adjusters receive $40.00 for initial and return visits to a large loss and $25.00 for smaller losses. Mileage is reimbursed at the standard IRS allowance, which is currently $0.37 per mile.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

Board of Directors

The board of directors consists of nine members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

Name	Principal Occupation	Residence	Expiry
Edward Emmer*	Retired farmer	Lomira, Wisconsin	2005
Roger Fink	Retired farmer	Mayville, Wisconsin	2005
Gary Zastrow*	Farmer	Mayville, Wisconsin	2005
Robert Belling*	Farmer	Lomira, Wisconsin	2006
Jerome Feucht*	Factory worker	Mayville, Wisconsin	2006
Steven Ries	Farmer	Lomira, Wisconsin	2006
Marvin Hahn	Retired farmer	Theresa, Wisconsin	2007
Rodney Justman*	Farmer	Mayville, Wisconsin	2007
Tracy Kinyon	Factory worker	Lomira, Wisconsin	2007

* Directors who are also agents are identified with an asterisk.

Members of the board currently receive $45.00 for each meeting attended, $65.00 for all day meetings, and the standard IRS allowance which is currently $0.37 per mile for travel expenses.

Officers

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

Name	Office	2003 Salary
Roger Fink	President	$2,800
Rodney Justman	Vice President	0
Marvin Hahn	Treasurer	4,900
Gary Zastrow	Secretary	6,750

Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. Accordingly, the board has established a Large Loss Adjusting Committee, whose purpose is to adjust larger claims, and an Inspection Committee, whose purpose is to inspect conditions of both new and renewal property. The committees at the time of the examination are listed below:

Large Loss Adjusting Committee	Inspection Committee
Roger Fink	Edward Emmer
Rodney Justman	Jerome Feucht
Gary Zastrow	Rodney Justman
Marvin Hahn	Tracy Kinyon
	Steven Ries
	Robert Belling (alternate)

Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

Year	Net Premiums Earned	Policies In Force	Net Income	Admitted Assets	Policyholders' Surplus
2003	$390,247	1,175	$ 160,824	$3,456,560	$2,957,897
2002	321,441	1,013	99,685	3,236,439	2,769,704
2001	308,700	1,013	(104,126)	3,257,798	2,724,254
2000	299,137	965	129,502	3,269,913	2,829,173
1999	385,699	986	179,021	3,093,383	2,640,798
1998	382,258	1,024	(15,421)	3,025,158	2,494,122

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

Year	Gross Premiums Written	Net Premiums Written	Ending Surplus	Writings Ratios	
				Net	Gross
2003	$843,921	$431,247	$2,957,897	15%	29%
2002	679,999	261,441	2,769,704	9	25
2001	696,149	328,700	2,724,254	12	26
2000	651,666	307,137	2,829,173	11	23
1999	619,305	369,230	2,640,798	14	23
1998	601,398	381,850	2,494,122	15	24

For the same period, the company's operating ratios were as follows:

Year	Net Losses and LAE Incurred	Other Underwriting Expenses Incurred	Net Earned Premiums	Loss Ratio	Expense Ratio	Com-posite Ratio
2003	$117,862	$218,907	$390,247	30%	51%	81%
2002	114,570	186,562	321,441	36	71	107
2001	356,913	179,612	308,700	116	55	171
2000	125,181	167,556	299,137	42	55	97
1999	148,149	160,662	385,699	38	44	82
1998	355,301	165,994	382,258	93	43	136

Overall, the company’s financial position has reported relatively steady growth during the five-year history period since the prior examination. Admitted assets have increased approximately 14% from $3.0 million to $3.5 million. Surplus has increased approximately 19% from $2.5 million to $3.0 million.

The company has reported positive underwriting and net income results in all years except for 2001, which was due to higher loss experience including fire and windstorm related claims. Investment income has remained relatively stable despite the declining interest rate environment. In-force policy and direct premium written growth increased significantly in 2003. The company attributes this premium growth to business expansion into new territories, which were added under the recent amendments to the articles of incorporation, and some policyholder transfers due to cancellations. The company's inspection program is utilized to assist in the evaluation of the risk associated with the above new business growth.

II. REINSURANCE

The examiner's review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2004
Termination provisions:	Either party may terminate the contract on any subsequent January 1 by providing 90 days advance written notice

The coverages provided under this treaty are summarized as follows:

1.	Type of contract:	Class A Casualty Excess of Loss
	Lines reinsured:	Non-Property
	Company's retention:	$500 in respect to each and every loss occurrence
	Coverage:	100% of any loss, including loss adjustment expense, in excess of the company's retention, subject to maximum policy limits as follows: a) $1,000,000 per occurrence, single limit, combined for bodily injury and property damage liability b) $1,000,000 split limits, in any combination of bodily injury and property damage liability c) $5,000 for medical payments per person; $25,000 per accident
	Reinsurance premium:	75% of premium written
2.	Type of contract:	Class B First Surplus
	Lines reinsured:	Property
	Company's retention:	Pro rata portion of each risk based on excess of $500,000
	Coverage:	Company may cede on a pro rata basis up to $800,000 when the company's net retention is $500,000 or more in respect to a risk Company may cede on a pro rata basis up to 50% of risk when the company's net retention is less than $500,000 in respect to a risk
	Reinsurance premium:	Pro rata portion of all premium, fees and assessments charged by the company, corresponding to the amount of each risk ceded hereunder

	Ceding commission:	Minimum Commission Allowance equal to 15% of premium paid to reinsurer Profit Commission of 15% of net profit accruing to the reinsurer during each accounting period in accordance with contract formulas
3.	Type of contract:	Class C-1 First Layer Excess of Loss
	Lines reinsured:	Property
	Company's retention:	$30,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of company's retention, subject to a $70,000 limit of liability in respect to each and every loss occurrence
	Annual aggregate deductible:	First $30,000 of paid losses otherwise recoverable under this contract shall be retained by the company Aggregate deductible shall be calculated on a per loss occurrence basis by applying an additional retention of $10,000 to each paid loss reported by the company until such time as the total annual aggregate deductible has been used
	Reinsurance premium:	Variable percentage of net premium written (NPW) based on the loss experience for the prior four years, subject to the following minimum and maximum rates: Minimum rate: 7.00% NPW Maximum rate: 20.25% NPW Current rate: 7.00% NPW Deposit premium: $40,200 payable in equal monthly installments of $3,350 Minimum premium: $32,000
4.	Type of contract:	Class C-2 Second Layer Excess of Loss
	Lines reinsured:	Property
	Company's retention:	$100,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of the company's retention, subject to a $100,000 limit of liability in respect to each and every loss occurrence
	Reinsurance premium:	2.75% of net premiums written subject to the following: Deposit premium: $15,900 payable in equal monthly installments of $1,325 Minimum premium: $13,000

5.	Type of contract:	Class C-3 Third Layer Excess of Loss
	Lines reinsured:	Property
	Company's retention:	$200,000
	Coverage:	100% of any loss, including loss adjustment expense, in excess of the company’s retention, subject to a $300,000 limit of liability in respect to each and every loss occurrence
	Reinsurance premium:	2% of net premium written subject to the following: Deposit premium: $11,400 payable in equal monthly installments of $950 Minimum premium: $9,200
6.	Type of contract:	Class D/E First Aggregate Stop Loss
	Lines reinsured:	All business lines written by the company
	Company's retention:	Losses, including loss adjustment expenses, in an amount equal to not less than 75% of net premium written, subject to a minimum net retention of $365,000
	Coverage:	100% of aggregate net losses, including loss adjustment expenses, in excess of the company’s retention
	Reinsurance premium:	Percentage of net premium written (NPW) based on the company’s loss experience for the prior eight years, subject to the following minimum and maximum rates: Minimum rate: 7.5% NPW Maximum rate: 25% NPW Current rate: 15% NPW Deposit premium: $105,600 payable in equal monthly installments of $8,800 Minimum premium: $73,000

III. FINANCIAL DATA

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2003, annual statement. Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

Theresa Mutual Insurance Company
Statement of Assets and Liabilities
As of December 31, 2003

Assets	Ledger	Nonledger	Not Admitted	Net Admitted
Cash in company's office	$ 50	$	$	$ 50
Cash deposited in checking account	30,227			30,227
Cash deposited at interest	464,494			464,494
Bonds	1,762,916			1,762,916
Stocks and mutual fund investments	834,164			834,164
Real estate	49,907			49,907
Premiums, agents' balances and installments:				
In course of collection	14,308			14,308
Deferred and not yet due	159,000			159,000
Investment income accrued		29,884		29,884
Reinsurance recoverable on paid losses and lae	1,767			1,767
Electronic data processing equipment	1,539			1,539
Other expense-related assets:				
Deferred commission receivable	5,100			5,100
Other nonexpense-related assets:				
Federal income tax recoverable	3,204			3,204
Western reserve annuity	100,000			100,000
Totals	$3,426,676	$29,884	$ 0	$3,456,560

Theresa Mutual Insurance Company
Statement of Assets and Liabilities (cont.)
As of December 31, 2003

Liabilities and Surplus

Net unpaid losses	$ 25,000
Unpaid loss adjustment expenses	1,500
Commissions payable	33,306
Fire department dues payable	988
Unearned premiums	325,000
Reinsurance payable	96,524
Other liabilities:	
Expense related:	
Accounts payable	207
Nonexpense related:	
Premiums received in advance	16,138
Total Liabilities	498,663
Policyholders' surplus	2,957,897
Total Liabilities and Surplus	$3,456,560

Theresa Mutual Insurance Company
Statement of Operations
For the Year 2003

Net premiums and assessments earned		$390,247
Deduct:		
Net losses incurred	$103,882	
Net loss adjustment expenses incurred	13,980	
Other underwriting expenses incurred	218,907	
Total losses and expenses incurred		336,769
Net underwriting gain (loss)		53,478
Net investment income:		
Net investment income earned	130,654	
Net realized capital gains	2,486	
Total investment gain (loss)		133,140
Net income (loss) before federal income taxes		186,618
Federal income taxes incurred		25,794
Net Income (Loss)		$160,824

Theresa Mutual Insurance Company
Reconciliation and Analysis of Surplus as Regards Policyholders
For the Five-Year Period Ending December 31, 2003

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	2003	**2002**	**2001**	**2000**	**1999**
Surplus, beginning of year	$2,769,704	$2,724,254	$2,829,173	$2,640,798	$2,494,122
Net income	160,824	99,685	(104,126)	129,502	179,021
Net unrealized capital gains or (losses)	27,369	(54,235)	(822)	58,531	(32,925)
Change in non-admitted assets	0	0	29	342	580
Surplus, end of year	$2,957,897	$2,769,704	$2,724,254	$2,829,173	$2,640,798

Reconciliation of Policyholders' Surplus

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2003 is accepted.

IV. SUMMARY OF EXAMINATION RESULTS

Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Underwriting—It is recommended that the company policy files include documentation to verify that there is coverage provided by another insurer and that the same type of policy with the same type of conditions has been issued to ensure that the company is not held liable for any loss payment over the intended percentage in a risk-sharing situation.

   Action—Compliance.

2. Disaster Recovery Plan—It is recommended that the company develop a written disaster recovery plan.

   Action—Compliance.

3. Invested Assets—It is again recommended that the company comply with s. Ins 13.05 (4)(f), Wis. Adm. Code, by requiring the presence and signature of at least two directors, officers or employees of the company when accessing the safe deposit box.

   Action—Compliance.

4. Investment Rule—It is recommended that the company adopt a written investment plan to comply with the requirements of s. Ins 6.20 (6) (h), Wis. Adm. Code.

   Action—Compliance.

5. Premiums Deferred and Not Yet Due—It is recommended that the company calculate deferred premium receivable on a per policy basis for future statutory financial statements.

   Action—Partial compliance. See further comments in the summary of current examination results under the caption “Premiums Deferred and Not Yet Due.”

6. Unearned Premium—It is recommended that the company use annual premium and a report date equal to the last day of the reporting period to calculate its unearned premium in future statutory financial statements.

   Action—Compliance.

7. Unearned Premium—It is recommended that the company ensure that reports used for unearned premium reflect all necessary data to support the calculation of pro rata factors.

   Action—Partial compliance. See further comments in the summary of current examination results under the caption “Unearned Premiums.”

Current Examination Results

Corporate Records

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof, were reviewed for the period under examination and also for the subsequent period.

The minutes of the board of directors do not formally record review and approval of major company transactions as it relates to investment purchases and sales. Examiner's review of the investment portfolio indicated exceptions to investment policy guidelines related to mutual funds which do not meet minimum rating requirements, as discussed further under the caption "Investment Rule Compliance." It is recommended that the board of director minutes formally acknowledge approval of investment transactions to provide a documented record of board of director oversight as it relates to the investment portfolio and to monitor compliance with Theresa Investment Policy and Town Mutual investment regulations.

The Large Loss Adjusting Committee and Inspection Committee membership identifies specific board member responsibilities for performing claim settlement and property inspection procedures. These committees do not meet as a group and hence no formal committee minutes are documented. Although committee business is apparently discussed at board meetings, the board minutes do not formally record committee oversight activities as it relates to property inspection completion in accordance with board directives, policy coverage restrictions or cancellations in accordance with adverse inspection findings and larger claim settlement status. It is recommended that the minutes of the board of directors provide a formal documented record of key oversight activities of the Large Loss Adjusting Committee and the Inspection Committee.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

Conflict of Interest

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for company officers and directors for the period under examination with no apparent conflicts being noted.

Fidelity Bond and Other Insurance

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

Type of Coverage	Coverage Limits
Fidelity Bond	$ 140,000
Worker's Compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Commercial Multi-Peril	
Fire	75,000
Extended Coverage	75,000
Liability	1,000,000
Medical Expense	1,000 per person
Aggregate limit	2,000,000
Fire legal liability	100,000
Combined Professional Liability and Directors & Officers Liability	
Each claim	2,000,000
Aggregate limit	2,000,000
Agents Errors and Omissions	
Each claim	1,000,000
Aggregate limit	1,000,000

Underwriting

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing.

The company has a formal inspection procedure for both new and renewal business. A sampling of new applications and renewal business is inspected by committee members who are independent of the risk under consideration and review. An inspection generally requires two committee members to be present, although the president or secretary may determine the number of inspectors on an individual case basis.

Claims Adjusting

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses under the guidelines previously discussed in the “Introduction” section of this report.

Accounts and Records

The examiner’s review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the handling of cash and recording of cash transactions by town mutual insurance companies. The examiner noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2003.

The company is audited annually by an outside public accounting firm.

EDP Environment

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is not specifically limited to people authorized to use the computer. While personal identification and password controls are not employed, the office staff uses a unique system code to gain access to the company's internal records. This was not considered an examination concern given the company's overall limited office staff and computer environment, which includes no form of on-line system access.

Company personnel back up the computers daily along with a complete system back-up on a weekly and monthly basis. Daily backed-up data is kept in the company's safe. The most current weekly and monthly backed-up data files are stored off premises. Backed-up data as of the most current year-end is stored in the safe deposit box facilities of the company's bank.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

Business Continuity Plan

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan based on prior examination recommendations, which was approved by the board of directors.

The company's disaster plan covers a brief description of its computer system, systems backup storage procedures, software vendor contact procedures, board of director responsibilities for establishing a temporary business location as needed in the event of disaster, independent auditor contacts, reinsurance contacts and other equipment and supply vendor contacts.

Invested Assets

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

(1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and

(2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

> Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company has implemented dual access controls over its bank safe deposit box since the prior exam and is in compliance with these requirements.

Investment Rule Compliance

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as “Type 2”) provided that the town mutual has a sufficient amount of lower risk investments (referred to as “Type 1”). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1.	Liabilities plus $300,000	$ 798,663
2.	Liabilities plus 33% of gross premiums written	777,157
3.	Liabilities plus 50% of net premiums written	714,287
4.	Amount required (greater of 1, 2, or 3)	798,663
5.	Amount of Type 1 investments as of 12/31/2003	2,375,128
6.	Excess or (deficiency)	$1,576,465

The company has sufficient Type 1 investments.

The above Type 1 investment calculation reflects changes to the company's Annual Statement Schedule of Investment Limitations due primarily to incorrect carry-forward of preferred stock totals and a few classification changes due to current ratings. While these adjustments reduced reported Type 1 investments by approximately $155,000, the company continues to significantly exceed its Type 1 investment threshold. It is recommended that the company correctly complete its Schedule of Investment Limitations pursuant to Town Mutual Annual Statement Instructions.

As of December 31, 2003, the company had one annuity investment, with a statement value of $100,000, and three closed-end nonrated mutual funds, with a statement value of $185,055, which are not in compliance with the new investment rule. The annuity was redeemed subsequent to the examination date. The mutual funds were noncompliant as of purchase date, since the investment rule requires that mutual funds have a 4-star or higher Morningstar rating.

The company's investment advisor indicated that two of the mutual funds are new funds (Calamos and Nicholas Applegate), which are typically not rated for the first two years, but are comparable to other open-ended funds currently rated 4-5 stars. The advisor indicates that the other mutual fund (Rydex Juno) represents an inverse bond fund, which serves as a bond portfolio hedge and is not rated. The company has requested permission to continue to hold these mutual funds within the "basket clause" provisions for other nonqualifying investments under the investment rule guidelines. The company's "basket clause" limit based on 5% of admitted assets would be approximately $173, 000 as of December 31, 2003. Amounts over the "basket clause" limit would be nonadmitted and require divestment under s. 612.36, Wis. Stat., which treats all Town Mutual assets as required to satisfy compulsory surplus requirements.

It is recommended that the minutes of the board of directors formally acknowledge and approve Town Mutual investment regulation exceptions and monitor investment in nonqualifying securities in accordance with permitted "basket clause" limits. It is further recommended that the company develop and execute a formal plan which provides for divestment of any nonqualifying investments purchased in excess of the permitted "basket clause" limits within three months of the adoption of the report.

ASSETS

Cash and Invested Cash **$494,771**

The above asset is comprised of the following types of cash items:

Cash in company's office	$ 50
Cash deposited in banks-checking accounts	30,227
Cash deposited in banks at interest	464,494
Total	$494,771

Cash in company's office at year-end represents the company's petty cash fund. A review of the last petty cash fund replenishment records was relied on based on the immaterial petty cash balance.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of the checking account balance was made by obtaining confirmation directly from the depository, as documented in the independent auditor’s workpapers, and reconciling the amount shown thereon to company records. The treasurer’s reconciliation documents the monthly balancing of general ledger cash accounting for all cash receipts and disbursements as well as a listing of outstanding checks and subsequent month clearing. It does not specifically document the reconciliation of the general ledger cash balance to the bank statement, although office staff total cash balancing procedures provide for compensating checks. It is suggested that the reconciliation of the ledger cash balance to the bank statement balance be incorporated directly in the treasurer’s monthly reconciliation process to better demonstrate bank statement agreement.

Cash deposited in banks represents the aggregate of eleven deposits in nine depositories. Deposits were verified by direct correspondence with the respective depositories, as documented in the independent auditor’s workpapers, and by an actual count and inspection of original certificates maintained in the safe deposit box at the company’s bank or verification to company’s investment custodial statement. Interest received during the year 2003 totaled $27,045 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 2.23% to 6.55%. Accrued interest on cash deposits totaled $4,567 at year-end.

Book Value of Bonds **$1,762,916**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2003. Bonds owned by the company are held under a safekeeping agreement with a bank.

Bonds were verified to applicable company investment custodial statement records, as documented in the independent CPA's workpapers. Bond purchases and sales for the period under examination were checked on a sample basis to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2003 on bonds amounted to $92,251 and was traced to cash receipts records. Accrued interest of $25,317 at December 31, 2003, was checked and allowed as a nonledger asset.

Stocks and Mutual Fund Investments **$834,164**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2003. Stocks owned by the company are held under a safekeeping agreement with a bank or stored in the safe deposit box at the company's bank.

Stock certificates were verified to applicable company investment custodial statement records, as documented in the independent auditor's workpapers, or to safekeeping in the safe deposit box at the company's bank. Stock and mutual fund purchases and sales for the period under examination were checked on a sample basis to brokers' invoices and advices. The company's investment in stocks and mutual funds was not in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. The nonconforming investments were related to mutual funds which do not meet the minimum requirements of a 4-star or higher Morningstar rating, as previously discussed under the caption "Investment Rule Compliance."

Dividends received during 2003 on stocks and mutual funds amounted to $38,137 and were traced to cash receipts records.

Book Value of Real Estate **$49,907**

The above amount represents the company's investment in real estate as of December 31, 2003. The company's real estate holdings consisted of its home office and an adjacent land parcel.

The required documents supporting the validity of this asset were reviewed and were in order. Adequate hazard insurance was carried on the real estate and contents as noted under the caption, "Fidelity Bond and Other Insurance." The company's investment in real estate and related items was in conformance with the Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers. Real estate depreciation is calculated using the straight-line or declining balance method.

Premiums, Agents' Balances in Course of Collection **$14,308**

This asset represents the amounts due from policyholders which are not in excess of 90 days past due at year-end. A review of individual policyholder accounts for subsequent premium payment verified the accuracy of this asset. In conjunction with the review of the above balances, it was noted that supporting Policy Balance Due Report controls included both balance due and other unbilled amounts which are not applicable. See further comments under the caption “Premiums Deferred and Not Yet Due.”

Premiums Deferred and Not Yet Due **$159,000**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. The premium system used by the company does not provide detail reporting controls of deferred premium by policyholder, as also noted in the prior examination report. Accordingly, the deferred premium balance was verified by reconciling to the difference between a report of unearned premium based on annual premium and a report of unearned premium based on billed premium. Unearned premium based on annual premium was independently recalculated for all in-force register records, as further discussed under the caption “Unearned Premiums.” Unearned premium based on billed premium was validated for the original cash receipts policy sample.

Follow-up with the company's system vendor indicated that various system enhancements are in process to address current examination issues which were noted related to the consistent reporting of premium receivables in course of collection as well as the lack of deferred premium reporting by policyholder. It is recommended that the company work with its system vendor to review, test and implement in-process system enhancements to provide for more effective reporting of premium receivable and deferred premium by policyholder.

Investment Income Due and Accrued **$29,884**

Interest due and accrued on the various assets of the company at December 31, 2003, consists of the following:

Cash deposited at interest	$ 4,567
Bonds	25,317
Total	$29,884

The above interest due and accrued balances were reviewed on a sample basis for reasonableness.

Reinsurance Recoverable on Paid Losses **$1,767**

The above asset represents recoveries due to the company from reinsurance on losses which were paid on or prior to December 31, 2003. No further detail review of this asset was performed based on the immaterial reinsurance recoverable on paid losses account balance.

Electronic Data Processing Equipment **$1,539**

The above balance consists of computer hardware and operating system software, net of depreciation as of December 31, 2003. A review of receipts and other documentation verified the balance. No further review was performed based on the immaterial data processing equipment balance.

Deferred Commission Receivable **$5,100**

This asset represents the amount of deferred commission receivable under an agreement with its reinsurer. The amount was verified to calculations based on deferred premium receivable reported by the company's reinsurer, Wisconsin Reinsurance Corporation, and estimated commission rates, as documented in the workpapers obtained from the company's independent auditors.

Federal Income Taxes Recoverable **$3,204**

The above asset represents the balance receivable at year-end from overpayment of federal income taxes incurred prior to December 31, 2003. The company's independent auditor tax calculations, including the verification of 2003 estimated tax payments, were reviewed to validate the reasonableness of this balance.

Other Assets - Western Reserve Annuity **$100,000**

The above asset represents the company's annuity investment, which was included in Mutual Fund balances reported on the company's general ledger. The company conservatively elected to recognize all income in conjunction with the subsequent redemption of this investment in 2004. Annuities are not specifically listed as authorized investments under Town Mutual investment regulations and hence no specific annual statement schedule exists for reporting such annuity investments. Accordingly, annuity investments should be monitored in accordance with the "basket clause" limits for nonqualifying securities, as previously discussed under the report section captioned "Investment Rule Compliance."

LIABILITIES AND SURPLUS

Net Unpaid Losses **$25,000**

This liability represents losses incurred on or prior to December 31, 2003, that remained unpaid as of that date. The examiner reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2003, with incurred dates in 2003 and prior years. To the actual paid loss figure was added an estimated amount for 2003 and prior losses remaining unpaid at the examination date, if any. The examiner's development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	Company Estimate	Examiner's Development	Difference
Incurred but unpaid losses	$1,091,000	$2,020,240	$929,240
Less: Reinsurance recoverable on unpaid losses	1,066,000	1,999,940	933,940
Net Unpaid Losses	$ 25,000	$ 20,300	$ 4,700

The above difference of $4,700 was not considered material for purposes of this examination.

The major factor contributing to the examination change to incurred but unpaid losses is a relatively large outstanding liability claim where the reserve balance as of December 31, 2003, of approximately $1 million has significantly increased due to interest accrued as of prior year settlement offer dates. The claim is fully reinsured by the company's reinsurer with the exception of the company's limited retention of $500 under its reinsurance contract. The policyholder was fully indemnified by the company despite the claim exceeding the policy limit.

This liability claim arises out of a 1996 accident that severely injured the driver of a motorcycle. The operator of the vehicle that struck the motorcycle failed to stop because there were tree branches obstructing the visibility of the stop sign. The tree was on the right of way and property of a Theresa Mutual Insurance Company policyholder. The court found that the county, township and the company's policyholder were all casually negligent as a matter of law. The court concluded that the defendants had maintained a public nuisance by failing to trim the tree at the stop sign. However, the liability of the municipalities was limited to $50,000 by statute.

Mediation as of 1999 indicated medical and wage loss damages of approximately $1 million. The plaintiff's counsel made a subsequent offer to settle for the policy limits of $1 million plus accrued interest dating back to a prior year settlement offer at 12%, totaling approximately $1,990,000. The company's reinsurer rejected this settlement offer and assumed all obligations of Theresa Mutual Insurance Company and its policyholder. The reinsurer's decision to reject the settlement offer was based on the opinion that the case has an excellent chance of successful appeal. The strongest argument in favor of a positive appeal outcome is that the court erred in not instructing the jury to regard the motor vehicle operator's obligation to yield the right of way as negligent.

The appeal has been filed as well as an appeal bond. The interest rate was set at 8% after March 2004 by stipulation of the parties. The reinsurer estimated that the appeal of this liability case to the court of appeals could require approximately two years and that the total amount due and owing to the plaintiff could approximate $2.5 million, if there is no reversal. A settlement of this claim was reached by the plaintiff, the reinsurer and the company later in 2004.

The examiner's review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed with the exception that the insured's signature was noted as waived or absent for approximately 20% of the sample.

The company's loss adjusting guidelines state that the proof of loss statement should be signed by both the policyholder and adjusters investigating the loss. Company follow-up indicated that the insured signature waiver was generally associated with smaller claims where onsite review was not deemed cost effective, lightning or electrical damage related claims where settlement primarily relies on supporting invoices to establish loss or instances where the insured declined to sign. It is recommended that the company's loss adjusting guidelines be updated to more specifically identify the criteria for authorized proof of loss signature waiver in terms of claim type, amount and other settlement factors along with loss adjuster proof of loss notation as to any guideline exceptions.

Unpaid Loss Adjustment Expenses **$1,500**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2003, but which remained unpaid as of year-end. The methodology used in establishing this liability relies on the independent auditor's estimates based primarily on travel expense associated with outstanding claims and past claims experience.

The examiner's analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

Commissions Payable **$33,306**

This liability consists of regular commission amounts due to agents, but not paid until after year-end. Supporting agent commission statements and subsequent cash disbursement verified this balance. It also includes an estimate for commission due on deferred premiums receivable, which was reviewed for reasonableness based on previously discussed deferred premium calculations.

It was noted that the company also pays a bonus commission on new fire and extended coverage policies. This bonus commission is paid annually in December for the prior 12 months activity. Bonus commissions paid in December 2003 were validated for a sample of the larger agent payments based on agent statement activity and board approved bonus commission rates of 15%. No accrual is recorded at year-end since the bonus commission is dependent on subsequent board of director approval, and any policy cancellations would require adjustment.

Fire Department Dues Payable **$988**

This liability represents the fire department dues payable at December 31, 2003. The examiner reviewed the company's fire department dues calculation and found this liability to be correctly calculated. The amount and subsequent payment was verified to this office's premium tax system records.

Unearned Premiums **$325,000**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established using a daily pro rata methodology.

Unearned premium was validated using vendor provided In-force / Unearned Premium Register records. Several vendor reiterations were required to obtain accurate electronic unearned premium files. System documentation supporting these file descriptions and unearned calculations was limited and system unearned reports do not reflect all data necessary to support the calculation of pro rata factors. Vendor system follow-up indicated various premium system enhancements are in-process, as previously discussed under “Premiums Deferred and Not Yet Due.”

Reinsurance Payable **$96,524**

This liability balance consists of amounts due to the company's reinsurer at December 31, 2003, relating to transactions which occurred on or prior to that date. The balance consists of:

December 2003 Reinsurer Billings	$32,032
2003 Year-end Ceded Premium Adjustments	30,518
Deferred Reinsurer Premiums	33,974
Total	$96,524

Subsequent cash disbursements and reinsurance accountings verified the reasonableness of this liability with immaterial differences noted related to the accrual for year-end adjustments.

Accounts Payable **$207**

This liability represents the balance payable at year-end for miscellaneous expenses. No further review was performed based on the immaterial balance.

Premiums Received in Advance **$16,138**

This liability represents the total premiums received prior to year end for policies with effective dates after December 31, 2003. The examiner reviewed Policy Prepaid Report controls and 2003 premium and cash receipt records for payments received with billing due dates subsequent to year-end to verify the accuracy of this liability.

V. CONCLUSION

Theresa Mutual Insurance Company has provided insurance to residents of Dodge, Fond du Lac and Washington counties and is celebrating its 125th anniversary in 2004. The company has expanded its insuring territory since the prior examination to include Columbia, Green Lake and Marquette counties.

Theresa Mutual Insurance Company has generally shown positive financial performance results over the five-year history period since the prior examination. Surplus levels have continued to increase over this period, increasing approximately 19% from $3.0 million to $3.5 million.

No adjustments to surplus were made as a result of this examination. The examination resulted in seven recommendations and one suggestion, as summarized in the "Summary of Comments and Recommendations" section of this report. The majority of recommendations relate to the desirability of a stronger board of director role in monitoring compliance with Town Mutual investment regulations and providing a more formal documented record of major company oversight activities as it relates to investment transaction approval as well as Loss Adjusting and Inspection Committee results and decisions.

VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 16 - Corporate Records—It is recommended that the board of director minutes formally acknowledge approval of investment transactions to provide a documented record of board of director oversight as it relates to the investment portfolio and to monitor compliance with Theresa Investment Policy and Town Mutual investment regulations.

2. Page 16 - Corporate Records—It is recommended that the minutes of the board of directors provide a formal documented record of key oversight activities of the Large Loss Adjusting Committee and the Inspection Committee.

3. Page 21 - Investment Rule Compliance—It is recommended that the company correctly complete its Schedule of Investment Limitations pursuant to Town Mutual Annual Statement Instructions.

4. Page 21 - Investment Rule Compliance—It is recommended that the minutes of the board of directors formally acknowledge and approve Town Mutual investment regulation exceptions and monitor investment in nonqualifying securities in accordance with permitted "basket clause" limits.

5. Page 21 - Investment Rule Compliance—It is further recommended that the company develop and execute a formal plan which provides for divestment of any nonqualifying investments purchased in excess of the permitted "basket clause" limits within three months of the adoption of the report.

6. Page 22 - Cash and Invested Cash—It is suggested that the reconciliation of the ledger cash balance to the bank statement balance be incorporated directly in the treasurer's monthly reconciliation process to better demonstrate bank statement agreement.

7. Page 25 - Premiums Deferred and Not Yet Due—It is recommended that the company work with its system vendor to review, test and implement in-process system enhancements to provide for more effective reporting of premium receivable and deferred premium by policyholder.

8. Page 28 - Net Unpaid Losses—It is recommended that the company's loss adjusting guidelines be updated to more specifically identify the criteria for authorized proof of loss signature waiver in terms of claim type, amount and other settlement factors along with loss adjuster proof of loss notation as to any guideline exceptions.

VII. ACKNOWLEDGMENT

The courteous cooperation extended to the examiner by the company's personnel is hereby acknowledged.

Respectfully submitted,

Tom M. Janke
Examiner-in-Charge